Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

To: The Commission

REPLY COMMENTS OF THE SOUTH DAKOTA TELECOMMUNICATIONS ASSOCIATION

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Executive Summary

The SDTA member companies ("South Dakota RLECs" or "SD RLECs") have made tremendous progress deploying broadband in the rural, high-cost areas of South Dakota. This progress was accomplished by designing and implementing efficient, long-term network deployment plans, leveraging the value of existing network facilities as a means of lowering total deployment costs, and undertaking incremental build-outs over time. The investment decisions of the SD RLECs were made in strict accordance with the existing FCC rules and policies in place at that time. Now, however, the previous rules which incented companies to invest in and deploy broadband-capable networks to their subscribers are being drastically reformed and a number of the specific reforms either already adopted or proposed for adoption actually penalize companies for their past investment decisions, which in a very significant way were driven by past universal service obligations.

SDTA was a concurring party to both the Initial and Reply Comments of the "Rural Associations" (NECA, NTCA, OPASTCO and WTA) previously filed with this Commission in response to the *Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking* released in these proceedings on February 9, 2011 (FCC 11-13). SDTA continues to support the positions and arguments of the Rural Associations set forth in these earlier comments and also those included in the Rural Associations' more recent Initial Comments filed on January 18, 2012 in response to the Commission's *Report and Order and Further Notice of Proposed Rulemaking*, released on November 18, 2012.

In these reply comments, SDTA emphasizes its objections to the Commission's proposals to eliminate or reduce high-cost support funding in areas that are deemed to be served by "unsubsidized competitors." The Commission has proposed to phase out, over three years, all high-cost support received by an incumbent rate-of-return carrier in study areas where an unsubsidized competitor, or a combination of unsubsidized competitors, offers voice and broadband service for 100 percent of the residential and business locations in the incumbent's study area. In addition, the Commission seeks comment through its most recent *Further Notice of Proposed Rulemaking* as to whether the proposal to adjust explicit support levels based on the presence of "unsubsidized competition" should be expanded, and even applied, in situations where broadband competition occurs on only a limited basis within existing RLEC service areas. SDTA strongly opposes the adoption and implementation of any of these "unsubsidized competition" triggers for support elimination or reductions. These proposals conflict with various provisions in the Telecommunications Act of 1996 (*i.e.*, Sections 214(e), 253(b), 253(f), and 254(b)) and are seriously flawed for failing to recognize the greater challenges of maintaining universal service, over the long-term, in the highest-cost, rural service areas and for failing to give any appreciable recognition of the important role that regulatory carrier-of-last-resort ("COLR") obligations and the preservation of existing rural service areas or "study areas" play in preserving and advancing universal service. SDTA urges the Commission to reconsider and set aside its proposed rule to completely phase-out high-cost support to rate-of-return carriers in service areas where "unsubsidized competition" is found to exist throughout the entirety of the area.

SDTA also opposes the Commission's proposed rule relying on the use of a quantile regression analysis as a means of capping, for high cost funding purposes, individual company capital investment and operating expense amounts. SDTA concurs in the Rural Associations' arguments related to the Commission's use of a "Regression Model," and with these comments, points out several technical errors in the current proposed regression model(s) which would lead to serious distortions in universal service support payments. SDTA believes that this Commission, as an alternative, should instead focus its efforts around making rule changes in accord with the "RLEC Reform Plan," the implementation of which SDTA believes would be consistent with statutory universal service principles.

SDTA also urges this Commission, consistent with the advocacy of the Rural Associations, to take prompt action to ensure that RLECs will be able to receive USF or CAF support when providing standalone broadband offerings, like "Naked DSL." It is obvious that the current high-cost funding rules, which for rural, rate-of-return ("ROR") carriers still require subscription to voice services as a support condition, actually stand as an obstacle to broadband subscription and broadband deployment. SDTA agrees with the Rural Associations' assertion that this current funding condition discourages and renders it very difficult financially for any RLECs to provide standalone broadband to customers desiring such service. Finally, SDTA agrees with the Rural Associations and urges the Commission to adopt a sufficient and predictable CAF mechanism for RLECs before imposing any extensive broadband-specific public interest obligations or additional reporting requirements on such carriers.

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REPLY COMMENTS OF THE
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I. Introduction

The Federal Communications Commission ("FCC" or "Commission") released a *Report and Order ("Report and Order") and Further Notice of Proposed Rule Making* ("*Further Notice*") in these proceedings on November 18, 2011 adopting new rules and proposing possible additional reforms related to federal universal service funding and intercarrier compensation.[1]

[1] *In the Matter of Connect America Fund,* WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Support*, WC Docket No. 05-

In response to the Commission's *Further Notice*, specifically, the Rural Associations filed Initial Comments setting forth arguments and positions regarding many of the questions and proposals raised by the Commission. SDTA, in these proceedings, participated as a concurring party in earlier Initial and Reply Comments of the "Rural Associations" (NECA, NTCA, OPASTCO and WTA) filed with this Commission in response to the *Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking* released in these proceedings on February 9, 2011 (FCC11-13). As the association in South Dakota representing all of this state's rural incumbent local exchange carriers ("RLECs"), SDTA continues to strongly support and agree with the arguments, positions, and specific reform proposals submitted by the Rural Associations. With these reply comments, SDTA provides supplemental arguments on several of the more significant proposals presented in the *Further Notice* that pose the greatest threat to the continued affordability and deployment of high quality broadband services in the SD RLEC service areas.

II. The Commission Should Abandon Its Proposal to Eliminate or Reduce High-Cost Support in Service Areas Where "Unsubsidized Competition" Is Deemed to Exist, at least with Respect to Rate-of-Return Carrier Service Areas.

In the *Report and Order* and *Further Notice,* the Commission indicates that it will be adopting rules and a specific process for discontinuing high-cost funding reimbursement to rate-of-return companies where 100% of the established service or study area is also served by an

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337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161, (Rel. Nov. 18, 2011). ("*Report and Order*") and ("*Further Notice*").

"unsubsidized competitor" which provides broadband services meeting the Commission's speed, latency and usage thresholds. Specifically, it is ordered that all high-cost loop support ("HCLS") to rate-of-return carriers in these situations would be phased out over three years. Like the positions set forth by the Rural Associations, SDTA opposes any elimination or reduction of any high-cost universal service support for rural, rate-of-return carriers based merely on a finding that there is "unsubsidized competition." The proposal to completely eliminate support when any such finding is made fails to give fair recognition to substantial investments already made and long-term financing obligations already assumed by regulated carries under the current high-cost funding rules. It also displays an outright disregard for various provisions in the Telecommunications Act of 1996 ("the Act") which were clearly intended to recognize the greater challenges of maintaining universal service, over the long-term, in the highest-cost, rural service areas.[2] At the present time, given the rate of technological change, the various broadband service platforms, and the number of broadband service providers operating in many parts of this country, it is, perhaps, easy to default toward uniform regulatory approaches that are not structured to take into account carrier and/or service area differences. In regard to the proposal to phase out universal support entirely in service areas where there is 100% overlap by an unsubsidized competitor, SDTA strongly urges the Commission to steer clear of applying any such proposal to rate-of-return carrier service areas. Rate-of-return carriers' historical provisioning of essential telecommunications services and the deployment of telecommunications networks in the highest-cost areas of this country does make one thing very clear: universal and high quality broadband services are not likely to be present in these cost-challenged areas without a decision by a carrier to make a long-term commitment and to

[2] Telecommunications Act of 1996, Pub. LA. No. 104-104, 110 Stat. 56 (1996).

undertake long-term plans for network investment. As SDTA has indicated in past comments filed with the Commission, the SD RLECs have made tremendous progress deploying broadband in the rural, highest-cost areas of South Dakota.[3] This has only been accomplished by designing and implementing efficient, long-term network deployment plans, leveraging the value of existing network facilities as a means of lowering total deployment costs, and undertaking incremental build-outs over time. The Commission's proposal to zero out high-cost support to any carrier, including rural carriers, relative to the recovery of any investment, past, present, or future, gives absolutely no recognition to the reality that substantial efficiencies can actually be achieved based on longer-term network deployment plans. This Commission, as well as the Federal-State Joint Board on Universal Service, has previously given recognition to the substantial progress already made with the deployment of broadband by many of the rural, rate-of-return carriers. It is also, on the other hand, a fact that many of the "unserved areas," those areas that currently do not have access to broadband services, sit within price-cap companies' service areas.[4] What explains this difference in broadband deployment? SDTA believes that it is the direct result of plain differences between the rural and price-cap carriers, and that contrary to what some may believe, is not merely tied to differences in annual high-cost funding amounts.

Successful deployment and maintenance of high-quality broadband services in the most rural parts of the United States requires any company to be in business for the long haul. Rural, rate-of-return carriers, most of which are cooperatives, small, locally-owned companies,

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[3] "Comments of the South Dakota Telecommunications Association" dated July 12, 2010, pp. 4-8.

[4] "Today, roughly half of the unserved housing units are located in the territories of the largest price-cap carriers, which include AT&T, Verizon and Qwest, while about 15% are located in the territories of mid-sized price-cap companies such as CenturyLink, Windstream and Frontier." See, National Broadband Plan at p. 141.

municipally-owned, or tribal-owned, are more closely tied to the communities and customers they serve. Cleary, this basic difference between small, rate-of-return carriers and the larger price-cap carriers has led to more efficient, longer-term network planning and more stable operations, and this has resulted in demonstrable universal service benefits in the form of greater service availability and higher service quality in rural carrier service areas.

In passing the Telecommunications Act of 1996, Congress opened the door to greater competition in telecommunications markets. Yet, Congress also clearly understood that the task of ensuring universal service in the highest-cost areas would be more difficult, and would require a more comprehensive approach. Accordingly, various provisions in the 1996 Act recognize the unique status and circumstances faced by smaller, rural carriers and prescribe different regulatory treatment of rural carrier operations. This includes: (1) provisions addressing competitive entry that are intended to prevent "cream skimming" by competitors in rural carrier service areas; (2) protections that require careful review by this Commission and state utility commissions prior to making any changes in established rural service areas; (3) protections that are intended to recognize and avoid the imposition of extreme interconnection burdens on rural carriers; (4) provisions that are intended to give state utility commissions the lead role in making public interest determinations as to which carriers should be eligible to receive explicit high-cost funding in rural service areas; and (5) provisions that also give state commissions the opportunity to take into account public interest considerations before supported carriers are able to discontinue the offering of essential services within established rural service areas.[5]

SDTA believes that all of these provisions in the Act have been critical to achieving today's broadband deployment successes. They appropriately take into account the important role both

[5] See, 47 U.S.C. §§ 253(f), 214(e), 251(f)(1) and (2), and 254(b).

this Commission and the states must play in maintaining and advancing universal service. They also have resulted in procedures that uniformly have enabled careful public interest review before existing regulatory obligations are changed or new regulatory obligations are imposed on rural carriers. The Commission's proposals to completely eliminate or reduce universal service support in the rural, rate-of-return carriers' service areas based merely on assumed objective standards for measuring the existence of competitive alternatives fail to recognize in any manner these various rural area safeguards set forth in the federal Act. An approach which relies solely on "unsubsidized competition" determinations as a "trigger" for reducing or eliminating universal service support is overly simplistic and fails to provide any means through which important short-term and long-term public interest considerations can be taken into account before universal service support is withdrawn from those areas that are the most difficult to serve. The approach, as currently vaguely outlined in the Commission's *Further Notice*, creates a level of regulatory uncertainty that is grossly out of sync with the realities of obtaining financing for investment in high-cost areas. It simply fails to consider the fact, noted above, that long-term commitments, supported by long-term financing, are essential and important to meeting universal service goals.

In general, it is obvious that the proposals to eliminate or reduce high-cost funding based on findings of "unsubsidized competition" have not been sufficiently reviewed by this Commission. These proposals, perhaps more than any of the USF reforms already adopted or proposed, have the potential to substantially disrupt and even threaten the very viability of many existing rural, rate-of-return carrier operations. SDTA strongly encourages the Commission to not throw caution to the wind and to more carefully examine the potential long-term consequences of its "unsubsidized competition" proposals.

A. The Commission's Proposal to Eliminate All High-Cost Loop Support in Service Areas Where "Unsubsidized Competition" Is Found to Exist Results in a Bias Against Rural Carrier Operations.

To avoid legal conflict with many of the specific "rural telephone company" provisions in the Act, this Commission cannot blatantly disregard the obvious and multiple differences between rural, rate-of-return carrier service areas and the urban and densely-populated areas served by price cap carriers. Not only do the Commission's "unsubsidized competition" proposals ignore important considerations with respect to what is required from a long-term perspective in meeting universal service goals, but they also fail to take into account the simple fact that rural carriers, due to their greater reliance on explicit high-cost funding, will be more negatively impacted by these proposals than other larger carriers. As SDTA has indicated in previous comments filed with this Commission, on average SDTA member RLECs receive approximately 24 percent of their total regulated revenues from the federal high-cost funding mechanisms. Proposed reforms that disregard even this basic fact effectively operate as a rural carrier penalty and are in direct conflict with rural safeguard provisions in the Act which, contrary to the "unsubsidized competition" proposals and many of the Commission's other USF reforms, are aimed at specifically addressing the real world differences between rural rate-of-return carrier operations and the operations of larger price cap companies.[6]

The Commission has simply failed to consider the devastating impact the proposed "unsubsidized competition" rule would have on the operations and investment of rural, rate-of-return carriers and the rural consumers they serve. The language of the Act requires the

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[6] It is also important to consider this greater reliance on explicit federal high-cost support in conjunction with the greater reliance of rural carriers on intercarrier compensation revenues. As SDTA has also noted in previous comments, the SDTA member companies receive, on average, approximately 28 percent of total regulated revenues from intercarrier compensation (including special access).

Commission to take into account the unique service considerations for rural areas and rural carriers. SDTA urges the Commission to do so and abandon any application of its "unsubsidized competition" rule and related proposals to rural carrier service areas.

B. The Commission's Proposed Rule to Eliminate or Reduce High-Cost Support in Areas Where "Unsubsidized Competitors" Offer Voice and Broadband Service Violates the Universal Service Principles Mandating "Specific, Predictable and Sufficient" Support.

In its analysis of the legal authority to enact certain rules and reforms, the Commission has also failed to consider the manner in which the unsubsidized competition rule and proposals interact with 47 U.S.C. Sections 254(b). Specifically, that section requires the Commission to preserve and advance universal service by guaranteeing access to telecommunications and information services, including advanced telecommunications and information services in rural and high-cost areas through "specific, predictable and sufficient" Federal and State mechanisms. SDTA jointly concurs with the analysis of the Rural Associations that the Commission's proposed rule, which would result in the elimination or reduction of high-cost support based merely on findings of "unsubsidized competition," would deprive companies of a "specific, predictable and sufficient" support mechanism.

Congress mandated "specific, predictable and sufficient" support so that consumers in all regions of the nation including rural and high-cost areas would have access to advanced telecommunications and information services that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. SDTA challenges the validity of any reforms that cause universal service support to not meet the "specific, predictable and sufficient" standards established under the Act. Currently, high-cost support for a rural carrier is based on the average, per-line cost of serving all of the lines in the rural service area or "study area," including the lower-cost lines in the more densely populated "in town" areas, rather than the actual costs of serving only the highest-cost lines in the study area. Under the Commission's proposed rule, the SD RLECs stand to lose universal service support funds in their study areas if unsubsidized competition is found to exist in 100 percent of the study area, regardless of investments already made to meet ETC and carrier-of-last-resort (COLR) obligations and regardless of whether or not, as carriers, they would continue to be subject to service obligations extending to all parts of their long-standing service areas.

In South Dakota, all incumbent LECs not only operate as ETCs based on prior state public utility commission designation, they also operate as carriers-of-last-resort under state law. As such, they are required to serve the entirety of each of their existing service areas, including the highest-cost, least-populated areas. Specifically, under South Dakota Codified Laws § 49-31-3.1, regulated local exchange companies may not discontinue "noncompetitive" basic local exchange voice services without first receiving express approval from the South Dakota Public Utilities Commission. In addition, it should be noted that all of the SDTA member companies are community-based and most operate as cooperative entities subject to state cooperative laws.[7] As community-based companies and cooperatives, many rural carriers are simply not positioned or able to trim their service offerings to only the lowest-cost customers within their service areas as a means of minimizing costs and offsetting universal service funding reductions. The Commission's "unsubsidized competition" rule and its related proposals fail to take into account these important carrier differences which have for many years have significantly contributed to achieving universal service goals. They also give no consideration to the key role that state

[7] 75.5 percent of all SDTA member company access lines are served by cooperative rural telecommunications carriers. 86.8 percent of all of the member company lines are served by either cooperatives, municipal or tribal rural telecommunications carriers.

commissions play in preserving universal service through the ETC provisions in the federal law or through the enforcement of "carrier-of-last-resort" (COLR) obligations established by state law. In addition, the "unsubsidized competition" rule proposed by the Commission, as the Rural Associations have noted, is "fundamentally unfair and counterproductive"[8] for failing to address investments already made by carriers pursuant to existing ETC obligations and existing cost recovery rules. SDTA member RLECs were able to obtain financing and have made substantial broadband investments under the existing federal rules.[9] The Commission now proposes to change the rules to include an "unsubsidized competition" disqualification and further proposes to apply this disqualification to investments already made by rural, rate-of-return carriers. Any such action is not only very questionable from a legal perspective, it is also very likely to substantially harm the ongoing operations of rural carriers by possibly stranding existing investment and risking default on outstanding loan obligations. These past investments were made based on the federal Act's promises that federal universal service funding would continue to be "specific, predictable and sufficient."[10] The Commission's proposal to hinge all explicit support determinations going forward on the presence or non-presence of "unsubsidized competition" is a clear violation of this promise, especially relative to investments already made based on past service obligations.

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[8] Rural Associations' Comments at p. 12.

[9] As noted in SDTA comments filed in these proceedings dated July 12, 2010, the rural telephone company members of SDTA invested over $133,196,000 in capital expenditures in 2008 and 2009, and the planned investments for 2010 and 2011 were approximately $91,966,000. Further, as of the time of those comments, the long-term debt of SDTA members included approximately $269 million in RUS or Federal Finance Bank loans and approximately $70 million in other bank loans. At EOY 2009, the SDTA members "Total Plant in Service" exceeded $1.14 billion, including plant attributable to both regulated and non-regulated service operations.

[10] 47 U.S.C. § 254(b)(5).

C. Adoption of Any Rule That Would Interfere with the Specific Role of State Utility Commissions Relating to ETCs or Prevent States from Imposing Carrier of Last Resort Obligations as a Means of Preserving Universal Service Is in Conflict with the Act.

The Commission must also explain how its proposal to eliminate or reduce high-cost support based solely on "unsubsidized competition" findings can be reconciled with the existing ETC designation and rural service area redefinition provisions in the federal Act. Under the plain language of Section 214(e), it is clear that Congress intended state commissions to retain authority over several integral regulatory functions, particularly in areas served by rural telephone companies. Indeed, state commissions are the regulatory bodies primarily responsible for granting Eligible Telecommunications Carrier designations,[11] for conducting the "public interest" reviews that are a prerequisite to granting more than one ETC designation in rural service areas,[12] for conducting the reviews that are necessary before permitting any existing ETC to relinquish its ETC status,[13] and also have joint responsibility with the FCC relative to rural service area redefinitions.[14] In addition, state commissions also have specific authority under the Act, within the context of service area redefinitions, and pursuant to the rural safeguard provided for under Section 253(f) to take action aimed at preventing the harmful effects of "cream skimming" by competitors within rural carrier service and exchange areas.[15]

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[11] 47 U.S.C. § 214(e)(2).

[12] *Id.*

[13] 47 U.S.C. § 214(e)(4).

[14] 47 U.S.C. § 214(e)(5).

[15] 47 U.S.C. 253(f) RURAL MARKETS- It shall not be a violation of this section for a State to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the requirements in section 214(e)(1) for designation as an eligible telecommunications carrier for that area before

The Commission's proposed "unsubsidized competition" rule and proposals in many respects appear inconsistent with these federal statutory provisions and the Commission has not outlined any specifics as to how conflicts with these provisions would be avoided. In fact, as described to this point, this approach of using an "unsubsidized competition" finding as a means of eliminating all high-cost funding to a single carrier would seem to largely displace the current ETC designation and ETC relinquishment processes. As already explained, using this approach as a driver for universal service funding decisions is seriously flawed from a public policy perspective. It is also raises a number of legal questions given the above cited federal Act provisions and related COLR obligations that typically arise under state law.

The proposed rule would appear to have the effect of preempting the authority granted to state commissions under Section 214(e) and also would seriously impede the ability of state commissions to enforce state COLR obligations. Because state commissions are uniquely situated to have more in-depth information on study areas, local exchange companies, and the competitive landscape of a particular area, Congress deemed them to be the appropriate agencies to manage a litany of responsibilities under Section 214(e). Section 214(e) permits telecommunications carriers designated as ETCs to receive universal service support if offering the required services throughout the service area. Customarily, it is state commissions who grant the ETC designation. Since Congress recognized that rural areas face unique challenges in provisioning advanced telecommunications and information services, it required state commissions to undertake a more rigorous public interest analysis before designating additional

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being permitted to provide such service. This subsection shall not apply--(1) to a service area served by a rural telephone company that has obtained an exemption, suspension, or modification of section 251(c)(4) that effectively prevents a competitor from meeting the requirements of section 214(e)(1); and (2) to a provider of commercial mobile services.

ETCs in areas served by a rural telephone company. In the event of an unserved area, state commissions are required to determine which carrier can best provide intrastate service (*i.e.*, local voice service) to an unserved area and order that carrier to provide those services to the identified unserved area. To ensure all areas and consumers will continue to have adequate service, state commissions are also charged to evaluate requests by ETCs to relinquish their designation. For the purpose of determining universal service obligations and support mechanisms, state commissions also have a direct role in establishing rural telephone company service areas. This Commission's proposed "unsubsidized competition" rule would work to effectively preempt these Section 214(e) responsibilities resting with state commissions by rendering any previous, state-granted ETC designation inconsequential as state commissions would be left with little, if any, meaningful oversight authority or functions. In spite of an RLEC meeting the ETC requirements and offering the requisite services throughout a service area in accordance with Section 214(e)(1), this Commission, upon concluding that "unsubsidized competition" exists within an area, would reduce or eliminate the support necessary to maintain those services. In such circumstances, many of the existing ETC provisions would be rendered meaningless. The same result occurs with respect to state COLR obligations. The Commission suggests in its *Report and Order* that affected regulated carriers would continue to be subject to any state-imposed voice service COLR obligations and that state commissions would remain able to impose state-defined COLR responsibilities. The continued imposition of these responsibilities, however, from a practical and legal perspective would not be possible if the Commission has already determined that no funding should be provided to the carrier and states are not able, on their own, to sufficiently fund those carrier that are required to meet the specific state-imposed COLR obligations. The Commission's proposed "unsubsidized competition" rule and proposals would inevitably force states to abandon or eliminate voice service COLR requirements in direct conflict with the Commission's statement that it would "decline to preempt state voice service requirements, including COLR obligations."[16] They would also appear to be in conflict with provisions in the Act indicating that the job of supporting nationally established universal service policies is to be shared between the federal government and the states.[17]

III. Under No Circumstances, Should Universal Service Support Be "Adjusted" in Rural Carrier Service Areas Where There Is Less Than 100 Percent Overlap by an "Unsubsidized Competitor."

The Commission also inquires whether high-cost support levels should be "adjusted" in areas where there is less than 100 percent overlap by an unsubsidized facilities-based provider of terrestrial fixed voice and broadband service.[18] In regard to this question, SDTA's answer, like that of the Rural Associations, is an unequivocal no.[19] Adopting any such proposal would have disastrous consequences for rural carriers and for consumers residing in the highest-cost rural areas. The Commission should recognize that breaking an RLEC's study area into smaller geographical units based upon a perceived competitive overlap is fundamentally inefficient and would only increase the level of explicit support needed to preserve and advance national universal service goals.

Furthermore, any proposal to reduce support for areas with less than 100% overlap should be rejected given the likelihood that it would have greater financial impact on rural

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[16] *Report and Order* at paras. 75 and 82.

[17] See, Sections 254(b)(5), 254(c), and 254(f).

[18] *Further Notice* at para. 1073.

[19] Rural Associations' Comments at p. 84.

carriers, and consequently, pose a greater risk of disrupting both voice and broadband service to consumers in rural carrier service areas. SDTA agrees with the Rural Associations' conclusion that implementing any such proposals would disrupt, if not destroy, the RLEC's network-based business plan, incenting or requiring cut backs on investment and service to the most expensive and difficult-to-serve consumers. Clearly, there are substantial differences between price-cap companies and rate-of-return companies in terms of the rural, high-cost areas they serve, the resulting high per-line cost, economies of scope and scale, and reliance on universal service funding and intercarrier compensation. These differences must be considered by this Commission and lead inexorably to the conclusion that "unsubsidized competition" findings and losses of explicit support, based on such findings, would inherently have a greater negative effect on rural carrier operations.

Unlike price cap carriers, any loss of federal universal service funding is simply more detrimental to smaller LECs that do not have the same ability to absorb and spread losses of support throughout a larger subscriber base. As an example, SDTA randomly selected three of its member companies to analyze and illustrate the effect of reduced support. SDTA analyzed the three companies' combined annual 2010 revenues ($13,755,294), which includes FUSF support ($6,748,728) and their 2010 annual expenses ($11,742,386). This analysis demonstrates that even a 30% decrease in USF support would reduce their net income to zero. USF revenue reductions of this magnitude would threaten the very viability of many smaller, rural carrier operations and would clearly violate both the standards of predictability and sufficiency established by Section 254(b)(5) of the Act.

Finally, if the Commission were to adjust support in areas where there is less than a 100% competitive overlap, either this Commission, the state commission or the incumbent carrier would be required to determine an accurate way to disaggregate costs between the area presumed to be competitive and those areas that do not receive the competitor's services. SDTA is unaware of any fair method of disaggregating costs for this purpose. Moreover, generally, a large percentage of the operating costs associated with regulated services may be fixed and may not vary substantially based on the number of customers that are served. This being the case, the Commission would not likely see any significant reduction in the costs that are determined on a per-line basis and eligible for high-cost reimbursement. Instead, it is likely that the Commission would see a substantial increase in the explicit support needed per-line in those portions of the rural carrier service area lying outside the area determined to be competitive. As the Rural Associations point out, the number of rate-of-return carriers exceeding the $250 per line per month cap adopted in the *Report and Order* would more than likely increase.[20] SDTA submits that any process designed to disaggregate cost and support would impose significant additional operating costs on smaller RLECs far outweighing any potential USF targeting benefits.

IV. The Commission's Proposed Regression Analyses/Models Will Not Result in Accurate or Appropriate Limits on Rural Carrier Capital Investment and Operating Expenses and Will Ultimately Result in Insufficient and Unpredictable High-Cost Loop Support.

SDTA continues to support the RLEC Plan as presented in April 2011.[21] The Rural Associations provide clear and convincing arguments as to why the Commission should move forward and adopt the RLEC Plan.[22] SDTA urges the Commission to reconsider its decision to employ quantile regression analyses or models in determining high-cost loop support ("HCLS")

[20] Rural Associations' Comments at p. 87.

[21] See, Rural Associations' April 18, 2011 Comments at p. 7-37.

[22] Rural Associations' Comments at p. 9-22.

for rural, rate-of-return carriers. It should, instead, adopt the RLEC Plan which, unlike the proposed "Regression Model," would be consistent with the statutory universal service principles. While SDTA provides comment below, reviewing and identifying various flaws in the regression models that are proposed, these comments should not in any way be interpreted as an endorsement of any use of quantile regression analyses or methods in determining universal service support distributions.

Under the Commission's proposed regression model,[23] limits are placed on the HCLS provided to carriers whose costs in specific accounts are significantly higher than other similarly situated companies. Support is then redistributed to those carriers whose unseparated loop cost are not limited through the operation of a specific benchmark that is also established. The proposed regression analyses or model, as described in Appendix H of the *Report and Order,* establishes limits on recovery under the HCLS mechanism for any study areas where costs calculated pursuant to any of the NECA algorithm steps are limited.[24] The Commission, in its *Further Notice,* seeks comment on using the presently described regression model as a means of limiting HCLS reimbursement, and proposes to implement the model for support calculations beginning July 1, 2012.

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[23] *Further Notice* at Appendix H.

[24] According to paragraph 12 of Appendix H, the methodology uses the 90th percentile because carriers with costs exceeding 90 percent of their similarly-situated peers may raise questions about the prudence of such expenditures. One SDTA member through the Commission's prescribed methodology is capped on cable and wire capital investment and associated depreciation expense for replacing their 1950 vintage copper plant with fiber facilities. The replacement took place over several years. The SDTA member replaced this outdated copper plant so its end users could receive access to the Internet at speeds greater than 56 Kbps. It would be very difficult to conclude that this investment was not done prudently; yet, the Commission's methodology produces results as if it was not.

SDTA agrees with the Rural Associations that there are many technical errors in the present regression model which would lead to serious distortions in universal service support payments.[25] The Rural Associations in their Initial Comments identified six technical errors or issues related to the current regression model. These errors result in limits on reimbursable capital and operating expenses that are arbitrary and capricious. The six errors or issues highlighted by the Rural Association are generally referenced below:

1. The geographical mapping data underlying the models is substantially inaccurate;
2. The Commission's application of statistical estimates to administer limitations fails to exclude only excessive costs;
3. The regression analysis does not properly identify capital and operating expenses;
4. By limiting individual account data, the Commission's proposed approach produces irrational results;
5. The use of independent variables in the Commission's model introduces unacceptable arbitrariness in the results achieved; and
6. The adverse impacts caused by the flaws in the analysis are serious and would eventually severely impact support payments to RLECs.[26]

SDTA agrees with all of these Rural Association findings and strongly urges the Commission to reconsider and reject any use of quantile regression analyses or models as a means of determining explicit high-cost funding for rural, rate-of-return carriers. Clearly, the regression model developed to this point fails in many respects to comply with the provisions of Section

[25] Rural Associations' Comments at p. 65.

[26] *Id.* at p. 65-71.

254(b)(5) mandating that the federal universal service support mechanisms be "specific, predictable and sufficient."

A. Applying Any Developed Regression Model Caps to Past Investment Clearly Results in High-Cost Funding that Is Unpredictable.

One of the most egregious aspects of the Commission's proposed use of a regression model, for purposes of determining universal service support distributions, is that no exception is even considered or mentioned with respect to past capital expenditures/investments. It goes without saying that any regression analyses or model being considered by the Commission "to *create* incentives or to provide better incentives for prudent capital expenditures"[27] is only relevant as a means of "incenting" future capital investment decisions. It is simply inappropriate to apply newly-adopted rules to past capital investments – expenses already booked and deemed prudent under regulations in effect at the time the expenses were incurred. Applying any new regression model rules in such an expansive manner would not only arguably violate legal "retroactive ratemaking" prohibitions, but would also result in a high-cost funding mechanisms that under any reasonable measuring stick should be viewed as "unpredictable." Any capital expenditure in the past considered prudent and previously deemed recoverable from a universal service funding standpoint would, under the Commission's present plans for use of its regression model, be at risk of being categorized as unrecoverable, and despite what the Commission appears to believe, the waiver process provided to rural, rate-of-return carriers does not, in itself, provide any reasonable offsetting assurance of revenue recovery. The result then, under the Commission's current plans, is an environment of unprecedented regulatory uncertainty, one in which few, if any, smaller, rural carriers serving the highest-cost areas could be expected to commit to any significant broadband investments. The Commission has, with its *Report and Order,* imposed

[27] *Report and Order* at para. 210.

additional broadband public interest obligations on regulated "rate-of-return" carriers. Yet, at the same time, under its proposed regression model rules, the Commission, by proposing that its model would be applied to past investments and by proposing that the model caps would change annually, the support amounts to any single carrier would be subject to very substantial changes on a year to year basis. This imbalance between the service obligations imposed on supposed "regulated carriers" and the universal service funding assurances provided is completely unacceptable and not legally sustainable.

B. The Commission's Proposal to Recalculate the Regression Model Caps on an Annual Basis Creates Even Greater Unpredictability.

The Commission proposes that the regression model caps used to limit reimbursable capital and operating expenses would be updated annually for each rate-of-return carrier with the first cap recalculated in July 2012. Through such process, each category of investment and expense would annually be subject to a new cap. The annual re-capping process leads to an even greater level of unpredictability, associated with unknowns concerning the capped amounts for the "next year," and would incent carriers to respond in ways that would be out-of-step with the Commission's universal broadband goals. Carriers would at least attempt to minimize the risk caused by the running of the next iteration of the model by investing in facilities and running their businesses, not based on the needs and best interests of their end users, but rather based upon the perceived investment and operations of companies they believe to be in their peer group.[28] Carrier decisions, rather than being tied to individual circumstances and needs, would instead be centered around reducing the risks of being capped in the next year and the resulting suppressed investments and/or expenses could in many respects run counter to the Commission's

[28] A company's investment decisions should be based on the needs of its subscribers, not on the predicted behavior of its peers.

universal broadband service goals and contrary to the universal service principles of Section 254(b). The Commission has simply not articulated any sound policy rationale justifying an annual recalculation of the regression model caps.

C. The Use of Multiple Investment and Multiple Expense Caps Results in a Flawed Regression Model.

As discussed in the *Report and Order*, the proposed model uses quantile regression analyses to generate a set of limits for each rate-of-return cost company study area which limits values used in eleven of the twenty-six steps in NECA's Cost Company Loop Cost Algorithm. The regression-derived limits were set at the 90^{th} percentile of costs for each individual step in the NECA's Cost Company Loop Cost algorithm. A company whose actual costs for a particular step in the algorithm are above the 90^{th} percentile compared to similarly situated companies would be limited to recovering amounts that correspond to the 90^{th} percentile of cost for that particular step in the algorithm.

More specifically, under the Commission's proposed model, limits are placed on HCLS provided to carriers whose costs are deemed to be excessive in specific capital and expense categories relative to companies that are similarly situated. The Commission proposes to redistribute HCLS support to those carriers whose unseparated loop cost is not limited by operation of the benchmark methodology.

SDTA believes that capping multiple investment and multiple expense categories and disallowing capped support amounts from being redistributed to any companies that fall outside any of the single cap amounts, results in a seriously flawed model. It again causes future support levels to be completely unpredictable and would discourage future investments and broadband service upgrades in many rural rate-of-return carrier service areas.

The Commission's proposed methodology does not place adequate emphasis on the total amounts each company has spent each year on capital investment or operating expenses during the year. It instead focuses on specific capital cost and expenses categories at more discreet levels, beyond what is either necessary or fair. A company capped in one category may be much more efficient than its peers in other categories. As a result, its overall capital investment and/or expenses may be less than its peers; however, since it was capped in one category, it would be ineligible for redistribution of capped support amounts because of the Commission's new rules.

The Commission's methodology only accounts for the amounts a carrier may be over the cap in one category, but does not account for amounts a carrier is under the caps in other cost categories. A carrier that is slightly over the cap in one category and considerably under the capped support amount in the remaining categories will be ineligible for redistribution of capped support amounts. However, one of the carrier's peers could be slightly under in all categories, incur higher overall cost compared to the capped carrier and be eligible for redistribution of capped support amounts. This methodology is not only strikingly unfair, but injects levels of complexity into the process which renders operation of the model difficult to discern, and which causes arbitrary support distributions. If the Commission is predisposed to using regression analysis, it must eliminate its use of multiple investment and multiple expense caps and must remedy all of the other errors identified by the Rural Associations.

D. The Geographical Mapping Data Underlying the Regression Model is Substantially Inaccurate.

As support for the Rural Association arguments noting the inaccuracies of the geographical mapping data used in the regression model, SDTA would bring the Commission's attention to certain data input errors that have already been discovered by a couple of the SDTA members. With respect to two of the SDTA members whose HCLS was limited as a result of the regression model caps, it has been determined that the geographical mapping data for these companies was substantially inaccurate. First, regarding the Kennebec Telephone Company, this Commission's model input file contains 305.633 square miles as the land area served. The actual size of Kennebec Telephone's service area is more than two times larger at 742 square miles. If the correct mapping data had been used, the number of categories in which Kennebec Telephone was capped would be reduced and the company's HCLS reduction for the period beginning July 1, 2012 would be substantially less.

A similar geographical mapping data error was also discovered by the West River Cooperative Telephone Company. The Commission's input file reports 260.557 square miles as the land area served by West River Telephone. The actual size of West River Telephone's service area is 6,209 square miles. If the correct mapping data had been used, the number of categories in which West River was capped would also be reduced. It was also discovered that the housing units for West River were way off from the actual number. The Commission's input file contains 564 housing units, while the actual number of housing units reported by West River is 3,526.

These errors not only substantially affect the end model results for Kennebec Telephone and West River Telephone, but once the data is corrected for these companies, there will be flow through impact on all of the other rate-of-return companies subject to the model. Any correction made for any company ultimately affects the high-cost loop support amounts of each of the other companies within their peer groups. This inter-dependence between all carriers resident in the workings of the model further illustrates the complexity of the model and the impossibility which each rural carrier would annually face in attempting to determine company specific impacts.

V. The Commission Should Take Prompt Action Allowing RLECs to Receive USF or CAF Support for the Provision of Standalone Broadband Offerings, Including "Naked DSL."

In their Initial Comments, the Rural Associations argue that the Commission must, at a minimum, ensure that RLECs are able to receive USF or CAF support for the provision of standalone broadband offerings.[29] SDTA agrees and strongly urges the Commission to take prompt action addressing the "Naked DSL" problem that is faced by most rural incumbent carriers. The current legacy universal service funding requirements which limit USF availability to common lines used to deliver regulated voice services undermine the Commission's stated fundamental objective of its current reforms -- to "ensure that all Americans are served by networks that support high-speed Internet access."[30] Very clearly, this current legacy funding condition discourages and makes it very difficult financially for RLECs to provide broadband on a standalone basis to consumers even where desired. It also has a negative effect on subscription to broadband services in the highest-cost rural areas which, in turn, negatively impacts broadband deployment in these areas. The cause of broadband adoption is hardly served by an artificial regulatory construct that compels the customer to buy voice service in order to obtain affordable broadband.[31] SDTA urges the Commission to promptly enable the funding of "Naked DSL" and other standalone broadband services offered by rural rate-of-return carriers.

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[29] Rural Associations' Comments at p. 22.

[30] *Report and Order* at para. 5.

[31] Rural Associations' Comments at p. 23.

VI. As Stressed by the Rural Associations, the Commission Should Step Away from Imposing Any Specific Broadband Public Interest Obligations on RLECs Until a Sufficient and Predictable CAF Mechanism for Rate-of-Return Carriers Is Adopted and Operational.

In regard to broadband-specific public interest obligations for RLECs, SDTA supports the positions promoted by the Rural Associations.

The Commission has determined that broadband connections meeting the 4 Mbps downstream and 1 Mbps upstream speed threshold and a latency of less than 100 milliseconds[32] will provide subscribers in rural and high-cost areas with the ability to use critical broadband applications in a manner reasonably comparable to broadband subscribers in urban areas.[33] Unfortunately, as the Rural Associations point out, "the obligations imposed on RLECs by the Order are not matched by the universal service support necessary to make these obligations achievable in RLEC service areas."[34]

For this reason, SDTA urges the Commission to adopt a predictable and sufficient CAF mechanism for RLECs before implementing any extensive broadband-specific public interest obligations or additional reporting requirements.

VII. Conclusion

SDTA appreciates the opportunity to submit Reply Comments on these important issues and looks forward to continued participation in this proceeding. SDTA respectfully requests the Commission carefully consider the arguments and positions set forth in these Reply Comments.

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[32] *Report and Order* at para. 96.

[33] *Id.* at para. 94.

[34] Rural Associations' Comments at p. 29.

Respectfully submitted,

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